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IN THE

Supreme Court of the United States

OCTOBER TERM, 1941

No. 286

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

SOUTHWEST CONSOLIDATED CORPORATION,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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Opinions Below

The memorandum opinion of the United States Board of Tax Appeals (R. 31-45) is unpublished. The opinion of the Circuit Court of Appeals (R. 63-67) is reported in 119 F. (2d) 561.

Jurisdiction

The judgment of the Circuit Court of Appeals was entered April 19, 1941 (R. 67). The petition for a writ of certiorari was filed July 19, 1941. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

Question Presented

The question presented, as raised by Petitioner's Specification of Errors (Petition, p. 5), is whether the basis of certain assets in the hands of Respondent, the taxpayer, was the figure at which they were bid in at foreclosure and receivership sales by a bondholders' committee representing holders of securities of a predecessor corporation. All of the assets of the old corporation were acquired by the taxpayer, pursuant to a plan of reorganization, in exchange for stock and stock purchase warrants of the taxpayer, which were distributed to the bondholders, claimholders and stockholders of the old corporation.

Statutes Involved

These are set forth in the Appendix, *infra*, pp. 12-15.[1]

Statement[2]

The taxpayer is a Delaware corporation, organized June 27, 1934. It is the successor of Southwest Gas Utilities

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[1] The quotations from the statutes contained in the Appendix to the Commissioner's Petition (pp. 10-12) do not reflect the retroactive amendments made by the Revenue Act of 1939.

[2] The summary statement of facts contained in the Commissioner's Petition (pp. 3, 4) does not reflect a number of details considered significant.

Corporation (herein called "Utilities"). Utilities was organized in 1928, also under the laws of Delaware. (R. 31.)

The financial structure of Utilities consisted of:

171,915	shares of common stock
32,244	shares of $6.50 preferred stock
$2,871,500	First Lien and Secured Sinking Fund Gold Bonds 6½% Series
$ 126,000	Five-Year 6% Convertible Gold Notes
$ 31,945.42	Unsecured claims

(R. 33, 34, 36).

The $2,871,500 of First Lien Bonds were secured by stocks and bonds of subsidiary companies, which were pledged under an indenture (R. 32).

On May 1, 1932, Utilities defaulted in the payment of interest on its First Lien Bonds. On May 2, 1932, a bondholders' committee was organized to protect the interests of the bondholders. About 85% of the outstanding bonds were deposited with this committee. Members of the committee became directors of Utilities, and after October 7, 1932 constituted a majority of the Board. (R. 32.)

On April 10, 1933, a bill in equity was filed in the Court of Chancery in the State of Delaware by one of the bondholders, alleging insolvency of Utilities and praying for the appointment of a receiver. Utilities admitted insolvency in that it was unable to meet its obligations as they matured, and consented to the appointment of a receiver. Two receivers were appointed. (R. 32.)

On March 7, 1934, the bondholders' committee adopted a "Plan of Reorganization," under which participating security holders of Utilities would receive common stock and warrants to purchase common stock of a new corporation (the taxpayer) to be formed to take over the assets of Utilities. The new corporation was to have only common stock outstanding. The terms of exchange were:

Bondholders to receive 20 shares of common stock of the new company for each $1,000 principal amount.

Note and Unsecured Claim Holders to receive 2 shares of common stock and 20 Class "A" warrants for each $1,000 principal amount.

Preferred Stockholders to receive 1 Class "B" warrant for each share held.

Common Stockholders to receive 1 Class "B" warrant for each 50 shares held.[3] (R. 33, 34.)

A Class "A" warrant was the right to buy one share of common stock of the new company at $6.00 a share during 1934 and at an increased price of $1.00 per share for each year thereafter up to and including 1938. A Class "B" warrant was the right to buy one share of common stock of the new company at $10.00 a share during 1934 and at an increased price of $5.00 per share for each succeeding year up to and including 1938. (R. 33, 34.)

The members of the bondholders' committee were permitted to intervene in the receivership proceedings against Utilities, and on May 11, 1934 the Chancellor issued a decree approving the Plan of Reorganization. Pursuant to the Plan of Reorganization, and by order of the Chancery Court, the assets pledged as security for the bonds of Utilities were sold by the trustee at foreclosure sale on June 25, 1934, and were bid in by the committee for $660,000. The unpledged assets of Utilities were bid in by the committee at public auction on June 18, 1934 for $92,000. The sales were confirmed by the Chancery Court. (R. 34.)

The taxpayer was organized on June 27, 1934 (R. 31). Pursuant to the Plan of Reorganization, all of Utilities'

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[3] It will be noted that under the Plan every type of interest in the old company had a continuing interest in the new company.

assets were transferred to the taxpayer upon its organization (R. 38) and the common stock and "A" and "B" warrants of the taxpayer were issued in exchange for bonds, notes, claims and stock of Utilities' as follows:

curity	Total Amount	Amount Participating in Plan	SOUTHWEST CONSOLIDATED Securities Issued in Exchange Pursuant to Plan		
			Common Stock	A Warrants	B Warrants
nds	$2,871,500.00	$2,450,500.00	49,010		
tes	126,000.00	107,000.00	214	2,140	
her Unsecured Claims	31,945.42	31,945.42	62	620	
ferred stock	32,244 sh.	17,297 sh.			17,297
mmon Stock	171,915 sh.	57,470 sh.			1,148 7/50
			49,286	2,760	18,445 7/50

(R. 36).

Non-participating security holders of Utilities Company received a pro rata distribution in cash (R. 37).

Holders of $871,500 principal amount of bonds and $65,000 of notes of Utilities participating in the Plan of Reorganization also held 3,020 shares of preferred stock and 5,627 shares of common stock of that corporation. With respect to their holdings of bonds and notes, these security holders received 17,560 shares of common stock and 1300 Class "A" warrants of the taxpayer. With respect to their holdings of common and preferred stock of Utilities these individuals received 3,132 Class "B" warrants. (R. 37.)

Giving effect to this situation, the following table shows total distribution of common stock and warrants to purchase common stock of the taxpayer to former stockholders of Utilities and to non-stockholders:

Class of security of Southwest Consolidated	Total issued by Southwest Consolidated	Issued to stockholders of Utilities	Issued to nonstockholders of Utilities
Common	49,286	17,560	31,726
Class "A" Warrants	2,760	1,300	1,460
Class "B" Warrants	18,445 7/50	18,445 7/50	—
Total	70,491 7/50	37,305 7/50	33,186

(R. 38).

Of the 2,760 Class "A" warrants issued by the taxpayer 1,760 were exercised, and of the 18,445-7/50 Class "B" warrants issued 4,623 were exercised, before they expired in 1938 (R. 38).

The cost to Utilities for the assets transferred to the taxpayer as of June 27, 1934 was $8,995,724.91. The fair market value of such assets on that day was $1,766,694.98.[1] (R. 38.)

The taxpayer filed its first income and excess profits tax return for the period June 27, 1934 to December 31, 1934, in which it reported a net loss of $48,307.10 (R. 38). In calculating this loss the taxpayer considered its cost for the assets taken over from its predecessor was the same as the cost to its predecessor (R. 39). The taxpayer's Federal income and excess profits tax return for 1935 also showed a net loss, which was similarly computed (R. 39).

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[1] On the basis of such value of assets of the taxpayer its Class "A" warrants when issued had an indicated value of about $29 per warrant and its Class "B" warrants had an indicated value of about $25 per warrant, viz: The taxpayer issued 49,286 shares of common stock. The assets behind the stock had a value of $1,766,694.98. Such value of assets would give a value per share of about $35. A Class "A" warrant was the right to buy one share for $6. and a Class "B" warrant was the right to buy one share for $10. Thus, a Class "A" warrant-holder could get about $35 of value for $6 (a difference of $29), and a Class "B" warrant-holder could get about $35 of value for $10 (a difference of $25).

In asserting the taxes in dispute the Commissioner claimed the cost of the total assets was the amount bid at the foreclosure sales (despite the fact the fair market value of such assets was admittedly far in excess of such bid prices). He then spread the aggregate purchase prices over the respective assets on the basis of their relative values (R. 25, 26). By so doing the Commissioner arrived at lower cost bases for the assets involved in the years in question than had been used by the taxpayer in filing its returns, and in this manner he arrived at net incomes for those years, with resulting taxes as asserted (R. 39).

The Board of Tax Appeals rejected the Commissioner's contention and decided there was no deficiency for either year (R. 46). The Circuit Court affirmed (R. 67).

Argument

1. This is not an appropriate case for consideration by the Supreme Court because it involves special and peculiar facts different from the facts of any of the pending cases alleged by the Government to raise like questions. The Government seeks clarification of the law on the question of the basis of property where the creditors of an old corporation become the *sole* stockholders of a new corporation, and the stockholders of the old corporation have no continuing interest. *That question is not raised here,*

In the present case under the terms of the Plan of Reorganization every type of interest in the old corporation, including the preferred and common stockholders, had a continuing interest in the new corporation. Based on the fair market value of the underlying assets, the "B" warrants issued to the stockholders of the old corporation

had an indicated value of $25.00 per warrant (See footnote 4, p. 6). Of these warrants 4,623 were exercised (R. 38).[5]

Thus, under the terms of the Plan, the common and preferred stockholders of the old corporation *qua* stockholders retained a continuing stock interest in the new corporation and became holders of a substantial amount of its stock.[6]

Furthermore, holders of about one-third of the bonds and more than one-half of the notes of the old corporation also held large blocks of preferred and common stock of the old corporation (R. 37, 38). As a consequence, *individuals who were stockholders of the old corporation actually received under the Plan shares of stock and stock purchase warrants amounting to more than 50% of the total number issued* (R. 38).

We submit there is no good reason for granting certiorari in a case involving these special and peculiar facts.

2. On the transaction in question the Commissioner has taken inconsistent positions. As to the new corporation,

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[5] The issuance of these warrants does not, as the Government contends (Petition, p. 9), take the transaction out of the "reorganization" definition of Section 112 (g) (1) (B). The warrants constituted *an interest in* voting stock. In a sense, they represented fractions of shares of voting stock since they entitled the holder to acquire a share of stock for less than its value. A distribution of such warrants has been characterized by this Court as "essentially analogous to a stock dividend." *Miles* v. *Safe Deposit & Trust Company*, 259 U. S. 247, 252.

[6] It is unimportant that it was a minority interest. In *Helvering* v. *Minnesota Tea Company*, 296 U. S. 378, and *G. & K. Manufacturing Co.* v. *Helvering*, 296 U. S. 389, transfers for cash and minority stock interests in the transferees were held to be "reorganizations," and in *Nelson Co.* v. *Helvering*, 296 U. S. 375, a transfer for cash and non-voting preferred stock was held to be a "reorganization."

he has claimed that there was no "reorganization." As to the holders of the securities of the old corporation, he has claimed there *was* a "reorganization," and consequently that they realized no deductible loss on the exchange of their old securities for the stock and warrants of the new corporation.[7] Section 112 (b) (3). As to the new corporation both the Board and the Circuit Court have held there was a "reorganization." As to the security holders of the old corporation, so far as known, all of them have accepted the Commissioner's claim that there was a "reorganization," and all of their cases for 1934, the year of the reorganization, have been closed on that basis; that is, without allowing them any losses.[8]

As the matter now stands all interested parties have been treated alike. It should stop there. No proper purpose is to be served by Supreme Court review of a case, involving special and peculiar facts, when any outcome different from that reached by the Board and the Circuit Court would create an inconsistent result unduly prejudicial to the interested taxpayers.

3. As stated in its Petition (p. 5), the Government is pressing this case because of the decisions in *LeTulle* v. *Scofield*, 308 U. S. 415, and *Helvering* v. *Tyng*, 308 U. S. 527. These cases were very little different from *Pinellas Ice Company* v. *Commissioner*, 287 U. S. 462. In the *Pinellas* case the consideration issued by the acquiring corporation was cash and short term notes: in the *LeTulle* case the consideration was cash and secured bonds: in the *Tyng* case it was cash and long term debentures. In all three cases this Court held there was a sale and not a "reorganization."

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[7] See Board of Tax Appeals proceedings of *George Belchic* and *Mrs. Alfrey Mitchell Belchic*, B. T. A. Docket Nos. 94810, 94809.

[8] If the Commissioner has any information to the contrary, we trust he will so advise the Court.

The *Pinellas* case was decided in 1933. In 1937 the Seventh Circuit decided *Commissioner* v. *Kitselman*, 89 F. (2) 458. There the *Commissioner* claimed that a transaction somewhat similar to the one here (although there the old stockholders received no interest in the new corporation) was a "reorganization." The Circuit Court upheld the Commissioner. The taxpayer petitioned for certiorari. The Government, through the Honorable Stanley F. Reed, Solicitor General, opposed the petition,[9] *and it was denied* (302 U. S. 709).

We submit, for the same reason the *Pinellas* case afforded no reason for the Supreme Court to grant, at the instance of the taxpayer, the petition in the *Kitselman* case, the *LeTulle* and *Tyng* cases afford no reason here.

The fact is the present case is totally unlike the *LeTulle* and *Tyng* cases. In each of those cases a corporation transferred its assets to another *which was owned by different interests*. The question was whether there was a sufficient continuing interest to make the transaction a "reorganization." Here there was in substance merely a recapitalization of a continuing business enterprise. Because of financial difficulties, the bondholders agreed to exchange their bonds for stock, the note and unsecured claim holders agreed to exchange their claims for stock and warrants, and the preferred and common stockholders agreed to exchange their stock for valuable warrants to purchase stock. In substance, the situation is practically the same as if no new corporation had been formed and, instead, the old corporation had been continued in existence with a new financial structure. The Commissioner contends that in the lat-

[9] See in that case the Brief for the Respondent in Opposition, pp. 12, 13.

ter case there is a non-taxable reorganization.[1] We submit he is inconsistent to claim otherwise here.

For these reasons the *LeTulle* and *Tyng* decisions clearly do not justify certiorari.

Conclusion

The petition should be denied.

Respectfully submitted,

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[1] *The Hoagland Corporation* v. *Helvering*, (C. C. A. 2) decided July 24, 1941, not yet reported.

Appendix

Revenue Act of 1934, c. 277, 48 Stat. 680, as amended by Revenue Act of 1939, c. 247, 53 Stat. 862:

Sec. 112. Recognition of Gain or Loss.

(*a*) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) • • •

(*3*) *Stock for Stock on Reorganization.*—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

(*4*) *Same—Gain of Corporation.*—No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

(*5*) *Transfer to Corporation Controlled by Transferor.*—No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange. Where the transferee assumes a liability of a transferor, or where the property of a transferor is transferred subject to a liability, then for the purpose only of determining whether the amount of stock or securities received by each of the transferors is in the proportion required by this paragraph, the amount of such liability (if under section 213 of the Revenue

Act of 1939 it is not considered as "other property or money") shall be considered as stock or securities received by such transferor. If, as the result of a determination of the tax liability of the taxpayer for the taxable year in which the exchange occurred, by a decision of the Board of Tax Appeals or of a court which became final before the ninetieth day after the date of the enactment of the Revenue Act of 1939, or by a closing agreement, the treatment of the amount of such liability was different from the treatment which would result from the application of the preceding sentence, such sentence shall not apply and the result of such determination shall be deemed proper.

* * * * * * *

(g) *Definition of Reorganization.*—As used in this section and section 113—

(1) The term "reorganization" means (A) a statutory merger or consolidation, or (B) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of substantially all the properties of another corporation, but in determining whether the exchange is solely for voting stock the assumption by the acquiring corporation of a liability of the other, or the fact that property acquired is subject to a liability, shall be disregarded; or the acquisition by one corporation in exchange solely for all or a part of its voting stock of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation, or (C) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its shareholders or both are in control of the corporation to which the assets are transferred, or (D) a recapitalization, or (E) a mere change in identity, form or place of organization, however effected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of a reorganization resulting from the acquisition by one corporation of stock or properties of another.

(h) *Definition of Control.*—As used in this section the term "control" means the ownership of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

* * * * *

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) Basis (Unadjusted) of Property.—The basis of property shall be the cost of such property; except that—

* * * * *

(6) *Tax-free Exchanges Generally.*—If the property was acquired after February 28, 1913, upon an exchange described in section 112 (b) to (e), inclusive, the basis shall be the same as in the case of the property exchanged, decreased in the amount of any money received by the taxpayer and increased in the amount of gain or decreased in the amount of loss to the taxpayer that was recognized upon such exchange under the law applicable to the year in which the exchange was made. If the property so acquired consisted in part of the type of property permitted by section 112 (b) to be received without the recognition of gain or loss, and in part of other property, the basis provided in this paragraph shall be allocated between the properties (other than money) received, and for the purpose of the allocation there shall be assigned to such other property an amount equivalent to its fair market value at the date of the exchange. Where as part of the consideration to the taxpayer another party to the exchange assumed a liability of the taxpayer or acquired from the taxpayer property subject to a liability, such assumption or acquisition (in the amount of the liability) shall, for the purposes of this paragraph, be considered as money received by the taxpayer upon the exchange. This paragraph shall not apply to property acquired by a corporation by the issuance of its stock or securities as the consideration in whole or in part for the transfer of the property to it.

(7) *Transfers to corporation where control of property remains in same persons.*—If the property was acquired after December 31, 1917, by a corporation in connection with a reorganization, and immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. This paragraph shall not apply if the property acquired consists of stock or securities in a corporation a party to the reorganization, unless acquired by the issuance of stock or securities of the transferee as the consideration in whole or in part for the transfer.

(8) *Property Acquired by Issuance of Stock or as Paid-In Surplus.*—If the property was acquired after December 31, 1920, by a corporation—

(A) by the issuance of its stock or securities in connection with a transaction described in section 112 (b) (5) (including, also, cases where part of the consideration for the transfer of such property to the corporation was property or money, in addition to such stock or securities), or

(B) as paid-in surplus or as a contribution to capital,

then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made,